ALTS
ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES

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General Counsel

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

May 5, 2000

Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: In the Matter of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer of Control, CC Docket No. 98-184

Dear Ms. Salas:

Please find attached an original and four copies of the Comments of the Association for Local Telecommunications Services in response to the FCC Public Notice, *Commission Seeks Comment on Additional Filings Submitted by Bell Atlantic Corporation and GTE Corporation*, CC Docket No. 98-184, DA 00-959 (rel. April 28, 2000).

Sincerely,

Jonathan Askin

cc: Julie Patterson, CCB, Policy and Program Planning Division (6 copies)
Janice Myles, CCB, Policy and Program Planning Division
International Transcription Service, Inc.

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
GTE CORPORATION,	)	
	)	
Transferor,	)	
	)	
and	)	CC Docket No. 98-184
	)	
BELL ATLANTIC CORPORATION,	)	
	)	
Transferee,	)	
	)	
For Consent to Transfer of Control	)	

COMMENTS OF THE ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES

The Association for Local Telecommunications Services ("ALTS"), pursuant to the Commission's April 28, 2000, Public Notice[1] hereby submits these comments on the additional supplemental materials filed by Bell Atlantic Corporation ("BA") and GTE Corporation ("GTE") (collectively, "BA and GTE" when identified pre-merger, and "Verizon" when identified post-merger) in the above-referenced proceeding.[2] ALTS contends that the proposed spin-off of GTE's interLATA assets is no more than an attempt to circumvent BA's 271 obligations. Nothing in the additional supplemental material submitted by BA and GTE changes this obvious

[1] Public Notice, *Commission Seeks Comment on Additional Filings Submitted by Bell Atlantic Corporation and GTE Corporation*, CC Docket No. 98-184, DA 00-959 (rel. April 28, 2000).
[2] Letter from William Barr to Magalie Roman Salas, *GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer of Control*, CC Docket No. 98-184 (filed April 28, 2000).

conclusion. The additional supplemental materials filed by BA and GTE are simply a reiteration of the sham spin-off BA and GTE proposed last January.[3]

ALTS is the leading national trade association representing facilities-based competitive local exchange carriers ("CLECs"). ALTS does not represent any of the major interexchange carriers and, therefore, its sole interest in this proceeding revolves around the effects of the merger on the market for *local* telecommunications services. It has long been ALTS' goal to open local telecommunications markets and break down barriers to competition to ensure that American businesses and residential consumers have a choice in their local phone service.

It is with this background that ALTS comments on the proposal of BA and GTE to transfer the interLATA assets of GTE to a newly-formed corporation ("Genuity") in which the merged companies would retain significant equity interests and control. ALTS believes that this proposal violates the mandates of Section 271 of the Telecommunications Act of 1996 ("1996 Act") and undermines the incentives of the merged parties to open their local markets to competition. The Commission must not approve the BA merger with GTE unless and until the divestiture of GTE's interLATA assets complies with the requirements of Section 271.

I. Overview

BA and GTE cannot lawfully merge so long as GTE provides interLATA services in in-region states for which BA has not received Section 271 approval. The statutory requirements are clear. It is unlawful for a Bell Operating Company ("BOC") to provide interLATA services in an in-region state before the Commission has found that the BOC has met the requirements of 47 U.S.C. § 271. This provision applies whether the service is provided with facilities owned

[3] *See GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer of Control*, CC Docket No. 98-184, Supplemental Filing of Bell Atlantic and GTE

originally by the BOC or acquired in a merger. This provision also applies to any affiliate owned or controlled by the BOC.

Rather than sanction the sham spin-off of GTE's interLATA assets, the FCC must make clear that Verizon must adhere to the same options available to any other BOC seeking to merge with a company that provides in-region interLATA services: (1) the BOC may obtain Section 271 approval for all in-region states; (2) the BOC may cleanly divest the interLATA business (as Qwest has proposed in the context of its merger with U S WEST); or (3) the BOC may abandon the proposed merger.

If BA and GTE wish to propose an arrangement with an option to recapture Genuity, then Verizon cannot be allowed to own more than 10 percent of Genuity until Verizon has obtained 271 approvals region-wide. Furthermore, Verizon cannot be allowed to control Genuity, either directly or indirectly, prior to obtaining 271 approvals in every state.

Section 271 provides BOCs with strong incentives to comply with the market-opening provisions of the 1996 Act. Permitting Verizon to provide interLATA services through Genuity would eviscerate Verizon's incentive to comply with the market-opening provisions of Sections 251 and 271. Moreover, sanctioning the spin-off of GTE's interLATA assets to allow BA to provide in-region interLATA services without complying with Section 271 would establish a dangerous precedent by which the other BOCs would undoubtedly attempt to circumvent their Section 271 obligations. The nascent competitive market would be severely harmed by allowing BA or any other BOC such a loophole through the strictures of Section 271.

The supplemental materials submitted by BA and GTE do nothing to change the fact that Verizon will maintain substantial control over Genuity, and every Genuity decision will be based on the likely result that within five years, Verizon will control and own most of Genuity. Even

(filed Jan. 27, 2000) ("Supplemental Filing").

under the revised spin-off proposal, Verizon's ownership can increase to 80 percent of Genuity. To make matters worse, the merged company has immediate representation on the Genuity Board. If Verizon's stake in Genuity is allowed to increase above 10 percent, and if there is Verizon representation on, and oversight of, the Genuity board, everyone at Genuity will understand that doing anything contrary to Verizon's long-term interests is tantamount to professional suicide. As a result, Genuity will not compete with BA, and BA will continue to have incentives to favor Genuity over other providers of interLATA services.

BA and GTE's proposed structure for Genuity translates into significantly more Verizon control over Genuity than BA and GTE would have the Commission believe. Verizon will wield overwhelming, if indirect, control over Genuity management, Genuity employees, and Genuity strategic decisions, violating the letter and the spirit of Section 271 of the Telecom Act. Section 271 clearly limits BOC control to 10 percent or less of an entity providing interLATA services. The corporate structure that BA and GTE intend to establish for Genuity essentially guarantees that Verizon will have *de facto* control over, an ownership interest in GTE's interLATA assets. BA and GTE cannot demonstrate otherwise. Everything Genuity does will necessarily consider the ultimate goals of Verizon. Thus, the spin-off proposal is a sham and an obvious end-run around Verizon's 271 obligations.

II. Section 271 of the Telecom Act Sets Forth the Terms By Which a BOC And Its Affiliate May Offer InterLATA Services.

Because the market-opening measures of Section 251(c) are counter to the inherent instincts, and the economic incentives, of the ILECs, Section 271 reinforces Section 251(c) by creating incentives to enhance the prospects for cooperation on the part of the BOCs. In Section 271, Congress wisely created a positive inducement for the BOCs to cooperate with these market-opening measures, by rewarding the BOCs with new competitive opportunities and new revenue streams if they open their local markets to competition . Section 271 applies not only the BOCs but also to their "affiliate[s]."[4] Affiliate is broadly defined and encompasses any entity in which a BOC "(directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership and control with another person."[5] For purposes of the latter definition, "'own' means to own an equity interest (or the equivalent thereof) of more than 10 percent."[6] When the requirements of Section 271 are satisfied in a given state, there the BOC or its affiliate is permitted not only to enter the market for interLATA services but also to expand the range of services it offers its vast existing consumer base, including new packages of services -- local and long distance, voice and data.

Congress attached a special significance to Section 271, as is most vividly demonstrated by the limitation on the Commission's otherwise extremely broad forbearance authority. Congress, understanding that the Act would unleash sweeping changes and create unforeseeable circumstances, decided to allow the Commission to essentially rewrite the law when certain conditions are met.[7] Therefore, Congress determined that the Commission "shall forbear from applying *any* regulation or *any* provision" of the Act to a telecommunications carrier or service, or class thereof, upon a determination that certain enumerated conditions were met.[8] Congress, however, expressly forbade the Commission to exercise this authority in two particular cases: Sections 251(c) and 271.[9] The reason, presumably, was to ensure that the Bell companies would

[4] 47 U.S.C. § 271(a).
[5] 47 U.S.C. § 153(1).
[6] *Id.*
[7] 47 U.S.C. §160.
[8] 47 U.S.C. § 160(a) (emphasis added).
[9] 47 U.S.C. § 160(d) ("[T]he Commission may not forbear from applying the requirements of section 251(c) or 271 under subsection (a) of this section until it determines that *those requirements have been fully implemented*") (emphasis added).

retain their incentive, as well as their obligation, to cooperate in replacing monopoly with competition.

Clearly, the Act is beginning to work to open local markets to competition. In those states where Section 271 applications have been seriously pursued, new entrants and state public utility commissions have experienced a softening of BOC opposition to market-opening requirements. By no means has this process been perfect (nor have the results), but the effects of the incentive scheme so carefully crafted by Congress are real, substantial, and decidedly beneficial. Conversely, if and to the extent that the Commission makes it possible for the BOCs to enter the interLATA business without first fulfilling all of their market-opening responsibilities, the incentive scheme crafted by Congress will be weakened, and the prospects for competition will diminish. One of ALTS' primary goals is to break down barriers to local market entry, so that consumers may reap the benefits of competition. ALTS cannot support any weakening of the incentives established by Congress.

III. The BA and GTE Revised Proposal Does Not Comply With Section 271.

The proposed spin-off of GTE's interLATA assets clearly violates FCC precedent. In fact, the FCC has never sanctioned such a flagrant disregard of Section 271, and has always held the BOCs to the strict requirements of Section 271 (*e.g.*, disallowance of BOC petitions for interLATA data relief pursuant to Section 706; denial of U S WEST LATA boundary modifications in Minnesota and Arizona). With competition just emerging, now is not the time for the FCC to diverge from this course.

The FCC, most recently, required Qwest to divest itself of all of its in-region interLATA

[10] 47 U.S.C. § 153(1).
[11] *Id.*

assets before the Qwest/U S WEST merger could be approved.[12] Unlike BA and GTE's proposal, the Qwest plan actually revealed an understanding that "in order to fully comply with Section 271, the buyer must be independent of [the merging party], and that the divestiture of customers must be final and irrevocable, *i.e.*, [the merging party] will have no preferential right to reaquire the customers it divests."[13] Even in the context of the Qwest divestiture plan, the FCC found the plan too vague and could not determine if the divestiture plan would result in a merger that complies with section 271. The FCC found that, in determining whether a BOC is providing interLATA service within the meaning of section 271, "we will balance several factors including, but not limited to, whether the BOC obtains material benefits . . . uniquely associated with the ability to include a long distance component in a combined service offering, whether the BOC is effectively holding itself out as a provider of long distance service, and whether the BOC is performing activities and functions that are typically performed by those who are legally or contractually responsible for providing interLATA service to the public."[14] When making that evaluation, the FCC will look at the "totality of [the BOC's] involvement," rather than any one activity.[15]

[12] *In the Matter of Qwest Communications International Inc. and US WEST, Inc., Applications for Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, Memorandum Opinion and Order, CC Docket No. 99-272, at para. 11 (rel. March 10, 2000) ("*Qwest/U S WEST Merger Order*").

[13] *Qwest/U S WEST Merger Order* at para 14.

[14] *Qwest/U S WEST Merger Order* at para 18 (citing *In the Matter of AT&T Corporation, et al., v. Ameritech Corporation and Qwest Communications Corporation; AT&T Corporation, et al., v. US WEST Communications and Qwest Communications Corporation; McLeodUSA Telecommunications Services, Inc v. US WEST, Inc.*, 13 FCC Rcd 21438, 21464-466, paras. 34-37 (1998) (*AT&T v. Ameritech*) *aff'd sub nom. U.S. WEST v. FCC*, 177 F.3d 1057 (D.C. Cir. 1999), *cert. denied*, (Feb. 28, 2000) (No. 99-869)).

[15] *Id.* (citing *AT&T v. Ameritech Order* 13 FCC Rcd at 21466, para. 37; McLeod Divestiture Plan Comments at 8).

The same analysis must apply to BA and GTE's sham spin-off of GTE's interLATA assets. Allowing the merged entity to participate on the Genuity Board and to increase its ownership of Genuity above 10 percent would effectively allow BA premature entry into the interLATA market by allowing BA to control policy of an entity that is offering interLATA services in BA's region, thereby undermining the incentive Congress created in section 271. Now is not the time to weaken the BOC's incentives to cooperate with new entrants.

BA and GTE have not demonstrated that their proposal precludes Verizon from obtaining an equity interest (or equivalent thereof) of more than 10 percent in the entity providing interLATA services, nor have they successfully demonstrated that Verizon would lack "control" of that entity. The merger parties purport to propose to divest 90 percent of their interLATA operations in a new entity. In fact, what they have in mind is selling off 20, not 90, percent of their interLATA operations, and retaining other kinds of control over the "divested" entity.

The spin-off proposal offers to transfer substantially all of GTE's existing interLATA business into Genuity which will be publicly owned and controlled. Public shareholders will be able to purchase Genuity Class A common stock, amounting to 90 percent of the voting rights and dividend distributions, while Verizon will receive shares of Class B stock of Genuity, amounting initially to 10 percent of the voting rights and distributed dividends. But the economic interest and the power that Verizon will retain are vastly greater than if, for example, Genuity had only one class of stock and 90 percent of *that* were to be sold off.

The key fact is that the Genuity Class B shares owned only by the merged parties are convertible into shares that will represent 80 percent of the outstanding shares following conversion. Thus, whenever the conversion right is exercised, Verizon -- *without paying* *anything to anyone* -- will own 80 percent of Genuity. With the stroke of a pen, the "90 percent" public ownership will become 20 percent.

The parties attempt to mask this maneuver by pointing to Commission precedent in an attempt to show that the merged entity will not own an equity interest in Genuity of more than 10 percent under the traditional indicia of equity ownership. Other parties have fully refuted those claims.[16] They have shown that options and other conversion interests are defined as equity in numerous contexts, and that the Commission itself has repeatedly recognized in its attribution order that options and other convertible interests create ownership and control at levels substantially below what BA and GTE would possess.[17] Furthermore, never has the Commission, or any court for that matter, considered such an ownership interest in the special context of Section 271. Given the unique role of Section 271 in national telecommunications policy (and in the statutory schema), precedents from other contexts cannot properly be invoked to justify deviations from the legislative requirements. Additionally, the structure and true value of the merged entity's interest in the newly formed company in no way resembles the 90 percent divestiture that the parties claim. No objective observer of the arrangements proposed here could reasonably conclude that the merged entity is limited to a 10 percent equity interest. Clearly, this would not be the view of Wall Street, the board members of this newly formed company, or its employees. Nor should this be the view of government official charged with ensuring that Sections 251(c) and 271 are fully implemented.[18]

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[16] AT&T Feb. 15 Comments at 11-18; AT&T March 10 Ex Parte at 3-9.

[17] *Id.*

[18] Furthermore, the interests of Verizon will be protected by certain investor safeguards that are sure to give the merged entity some level of control over Genuity. The merged entity will have the right to approve certain business decisions and changes that they deem adversely affect Verizon's minority investment and conversion rights. The merged entity will exercise substantial "control" of Genuity.

From the outset of this proceeding, the parties have clearly known that, if the proposed merger is effectuated, the combined entity will be subject to the same interLATA prohibition that currently applies to BA. They have also known that this prohibition applies to the interLATA services provided by Genuity. Yet, despite this awareness, the parties have never fully appreciated the seriousness of the Section 271 impediment.

The Commission has shown great wisdom and fortitude in rejecting efforts by various Bell companies to eviscerate Section 271. The Commission denied five unmeritorious Section 271 applications. It rejected proposals to create a single, national "data LATA." It declined to waive or forbear from Section 271 in the context of "advanced services."

Wisdom and fortitude are required once again to properly dispose of the latest proposal. The supplemental materials submitted by BA and GTE attempt to dodge the application of Section 271 to the merger but still allow the merged entity to retain a very substantial interest in an Internet backbone and interLATA business that conducts interLATA activities in BA's "in-region" states for which Section 271 authority has not been granted. Thus, instead of BA (and now GTE) experiencing a strengthening of their desire to obtain interLATA authority (and a concomitant increase in their willingness to fulfill their market-opening responsibilities), they would, if this proposal were granted, be able to continue a substantial interLATA business without first fulfilling the competitive checklist and other requirements of Section 271.

IV. More, Not Fewer, Assurances of BA Compliance with Section 271 Are Needed.

BA has already demonstrated that it cannot be trusted to abide by its merger conditions and 271 obligations. In order to demonstrate compliance with the BA/NYNEX merger conditions, BA agreed to submit monthly performance reports to the FCC. The FCC recently took the BA compiled data (which presumably depicts BA's market opening activity in its best light), and plotted several charts depicting BA's provisioning of services and UNEs to its own retail customers and requesting CLECs. The charts reveal a consistent, disturbing trend. While BA's provisioning of services to its own retail customers shows general improvement, BA's provisioning of UNEs to CLECs is deteriorating.[19] Among the goals of the merger conditions imposed on BA, in the context of its merger with NYNEX, was to ensure that BA opened its markets to competitors. BA's own performance reports belie this worthy goal.

More recently, BA has demonstrated that once it is granted 271 relief, it cannot be trusted to abide by its 271 obligations. The FCC was forced to fine BA for its failure to abide by its OSS obligations in New York and the New York Public Service Commission has been forced to monitor vigilantly BA's ongoing behavior post 271 approval. In order to ensure compliance in New York, BA shifted resources from other jurisdictions into New York. The result is that other states are reportedly being deprived of the resources necessary to allow for competitive entry. There is every reason to believe that BA will give short shrift to all those less lucrative states in its region if BA is allowed to circumvent Section 271 via its affiliate, Genuity.

ALTS proposes that the FCC specifically and explicitly obligate BA and GTE to agree to abide by all of the market opening conditions set forth in Section 271 in all of its states before Verizon is allowed to control or own more than 10 percent of Genuity, or otherwise provide interLATA services region-wide.

V. Conclusion

BA and GTE's proposed spin-off of GTE's interLATA assets is quite simply an obvious attempt to evade the application of Section 271 to their proposed merger. Nothing in BA and

[19] http://www.fcc.gov/ccb/asd/BA_NYNEX/perfMonGraphs.html

GTE's additional supplemental materials filed in this proceeding changes the fact that Verizon would effectively be using Genuity as a means to provide in-region interLATA services before satisfying Section 271. Allowing Verizon to circumvent its Section 271 obligations would thwart the delicate balance that Congress struck when crafting Section 271 and would undermine the series of well-reasoned FCC decisions carrying out the mandate of Section 271.

Respectfully submitted,

THE ASSOCIATION FOR LOCAL
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